

Service Date May 17, 1982

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

IN THE MATTER of the Application of)	UTILITY DIVISION
the MONTANA POWER COMPANY for)	DOCKET NOS. 81.3.28
Authority to Increase Rates and)	& 81.6.57
Charges for Natural Gas Service.)	ORDER NO. 4775b

APPEARANCES

FOR THE APPLICANT:

Dennis R. Lopach, Hjort and Lopach, Arcade Building, P.O. Box 514, Helena, Montana 59624.

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FOR THE INTERVENORS:

James C. Paine, Montana Consumer Counsel, 34 West Sixth Avenue, Helena, Montana 59620

Richard F. Gallagher, Church, Harris, Johnson & Williams, Northwestern Bank Building, Great Falls, Montana 59401, appearing on behalf of the Great Falls Gas Company.

Anne MacIntyre, 207 East Main, Missoula, Montana 59801, appearing on behalf of District XI, Human Resources Counsel, Inc.

FOR THE COMMISSION:

Eileen E. Shore, Staff Attorney
Dan Elliott, Administrator, Utility Division
Eric Eck, C.P.A.

BEFORE:

GORDON E. BOLLINGER, Chairman
JOHN B. DRISCOLL, Commissioner
HOWARD L. ELLIS, Commissioner
CLYDE JARVIS, Commissioner

THOMAS J. SCHNEIDER, Commissioner
FINDINGS OF FACT

PART A

General

1. On March 10, 1981, the Montana Power Company (MPC, the Company or Applicant) filed with the Commission a natural gas tracking application. The application seeks approximately \$15.848 million in increased annual revenues for natural gas service. Of this amount, \$6.85 million reflects the impact on total gas supply costs, as found in order No. 4714a, of the increase in the Canadian Border Price from \$4.47 per MMBTU to \$4.94 per MMBTU effective April 1, 1981. The balance, approximately \$9 million, reflects changes in the natural gas mix and market conditions from those in Order No. 4714a.
2. On April 3, 1981 the Commission issued Interim Order No. 4775 which granted additional annual revenues in the amount of \$2,227,606.
3. On May 14, 1981 MPC filed an application to amortize \$1,481,671 of the negative deferred gas cost balance. This application was incorporated into Docket No. 81.3.28.
4. The June 19, 1981 general filing requested \$15,683,417 over the revenue level produced by the rates approved in Order No. 4775. The effective increase request over the last permanently authorized rates from Order No. 4714a, including the effect of temporary rates approved in Order No. 4775, became \$17,445,343.
5. The Montana Consumer Counsel (MCC) has participated in this Docket on behalf of the consuming public since the inception of these proceedings .
6. On July 1, 1981, MCC submitted a motion to consolidate the general gas rate increase filing with the pending gas tracking and deferred accounting case.
7. On July 20, 1981 Docket Nos. 81.3.28 and 81.6.57 were consolidated.
8. On August 3, 1981, the Commission issued a procedural order.
9. On August 18, 1981, pursuant to notice of public hearing, a hearing on the petition for interim relief in this proceeding was held at the Public Service Commission offices, 1227 11th Avenue, Helena, Montana.
10. On August 31, 1981 the Commission issued Interim Order No. 4775a which granted additional annual revenues in the amount of \$8,578,150.

11. On December 8, 9 and 10, 1981, commencing at 10:00 a.m., pursuant to notice of public hearing, a hearing was held in the Senate Chambers of the State Capitol Building at Helena, Montana. During the hearing in December MPC presented an exhibit which indicated that the natural gas market had declined from 33,268 MMcf to 30,969 MMcf. MCC urged the Commission to reject the market update because revenues, expenses and investment had not been revised. In order to eliminate concern over the matching principle, MPC proposed to file revised data as soon as it could be compiled.

12. MPC agreed to waive the nine month statute for the length of time it took to prepare the revised data and to hold an additional hearing (i.e. from December 10, 1981 to January 29, 1982).

13. On January 29, 1982, pursuant to notice of public hearing, a hearing was held in the Senate Chambers of the State Capitol Building at Helena, Montana, commencing at 10:00 a.m.

14. Evening meetings were held at; Helena, January 29, 1982, in the Senate Chambers of the State Capitol Building at 7:00 p.m.; Great Falls, February 1, 1982, in the City Council Chambers at 7 :00 p.m.; Butte, February 2, 1982, in the Student Union Building, Montana College of Mineral Science and Technology at 7:00 p.m., and Missoula, February 3, 1982, in the City Council Chambers, at 7:00 p.m. These hearings were designed to encourage participation by the general public.

15. Applicant proposes that the 13 month period ending September 30, 1981, adjusted to reflect known and measurable changes, be used as the test period in this Docket.

16. The September, 1981 test year is found by the Commission to be a reasonable period within which to measure Applicant's utility revenues, expenses and returns for the purpose of determining a fair and reasonable level of rates for natural gas service.

PART B

RATE OF RETURN

Capital Structure

17. Applicant proposed the following capital structure and associated costs:

Capital	Weighted
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<u>Type</u>	<u>Structure</u>	<u>Cost</u>	<u>Cost</u>
Long-Term Debt	44.40%	8.81%	3.91%
Preferred Stock	13.46	8.63	1.16
Common Stock	41.60	15.50	6.45
Investment Tax Credit	.54	11.58	.06
	<u>100.0%</u>		<u>11.58%</u>

18. MCC proposed the following capital structure and associated costs:

<u>Type</u>	<u>Capital Structure</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-Term Debt	48.33%	8.81%	4.26%
Preferred Stock	13.58	8.63	1.17
Common Stock	<u>38.09</u>	13.75	<u>5.24</u>
	<u>100.0%</u>		<u>10.67%</u>

19. Applicant's witness Frank Woy presented a capital structure based upon the consolidated capitalization at March 31, 1981 as reported to the Securities and Exchange Commission. Nonutility subsidiary retained earnings and long-term debt were deducted from the capital structure. In addition, retained earnings from Canadian-Montana Pipe Line Company allocated to Aden were deducted from common equity. Common equity was reduced by the amount of capital surplus associated with the fair market value of the Mystic Lake Plant. Common equity was increased to reflect the April, 1981 sale of 1,500,000 shares and preferred stock was reduced for expenses related to the December, 1980 preferred stock issue. After removing miscellaneous investments and investments in nonutility subsidiaries, 24 percent of the total utility capital structure was allocated to natural gas. The 24 percent allocation factor was based on the relationship of the unadjusted natural gas rate base to the total utility rate base at September 30, 1980 (Direct, p. 6).

20. The Applicant included post-1970 investment tax credits in the capital structure to comply with Internal Revenue Service Regulations.

21. MCC witness Basil Copeland allocated MPC's total capitalization among nonutility operations, electric utility operations, and gas utility operations. In removing investment in

subsidiaries, Copeland eliminated all equity in subsidiaries, rather than just the undistributed earnings. Second, Copeland removed investment in subsidiaries from only the equity portion of the capital structure. Finally, Copeland did not include investment tax credits in the capital structure.

22. Two distinct issues are present in this Docket relative to the capital structure. The first issue is whether or not investment tax credits should be included in the capital structure. In the past the Commission has excluded the investment tax credits because the overall rate of return is unchanged. MPC argued that failure to include investment tax credits in the capital structure violated a Treasury regulation. George Hess, a witness for MCC was asked about the Treasury regulation:

Q. If you do not include your unamortized investment tax credit in your capital structure, haven't you, according to this regulation, deducted it from rate base?

A. No, I have not. I point out in my testimony that you get the same rate of return whether you include it or exclude it from capital structure, and I then apply that rate of return to a rate base that has not been reduced and includes investment that has been funded by post-1970 unamortized tax credits. (Tr. p. 423)

This issue is unchanged from Docket No. 80.4.2 where the Commission found the exclusion of investment tax credits from the capital structure to be correct. The Applicant failed to meet its burden of proof with respect to the inclusion of investment tax credits. Therefore, the Commission finds the exclusion of investment tax credits proper.

23. The second issue is how to best eliminate nonutility investments from the capital structure. Copeland noted in his direct testimony that the first mortgage bonds of the Applicant are supported entirely by utility property. Since nonutility operations do not help to support first mortgage bonds in terms of secured-property, it seems logical to exclude debt from consideration as a source of capital for those operations. Since the approved capital structure is used to set rates for utility service, the total investment in nonutility subsidiaries must be removed from the capital structure. The Commission finds the arguments on capital structure presented by MCC persuasive and, therefore, adopts the capital structure advocated by MCC.

Cost of Debt

24. The cost of long-term debt is not a contested issue in this case. Both MPC and MCC found the cost of long-term debt to be 8.81 percent. This cost is acceptable to the Commission. (Exh. BLC-1, Sch. IV)

Cost of Preferred Stock

25. As was the case with long-term debt, the cost of preferred stock is not a contested issue. Both the Applicant and MCC found the cost of preferred stock to be 8.63 percent. This cost is acceptable to the Commission.

Cost of Common EquityApplicant

26. Frank Woy presented the cost of capital requested by the Applicant in this proceeding. In an interesting departure from the traditional discounted cash flow analysis, Woy recommended a return on common equity which would enable the company to achieve certain specified financial objectives.

27. The primary criteria used by Woy to develop the cost of common equity were interest coverages, achieved return on common equity, internal funds generation as a percent of capital requirements and capitalization ratios. It is an objective of the Montana Power Company to achieve a strong Single A utility rating.

28. If the requested return was authorized by this Commission, a before-tax interest coverage in the 2.75-3.50 range would result, according to Woy. In the years 1978 through 1980 the earned returns for the natural gas utility were deficient and a loss was incurred by the common shareholder. With the exception of 1980, approximately 45 percent of the gas utility's construction funds are internally generated. Due to recent sales of securities, the present financial capitalization ratios are favorable, in Woy's opinion. The lowest cost of common equity which will meet these financial objectives according to Woy is 15.5 percent. (Direct p. 7)

MCC

29. Basil Copeland, an independent financial consultant, presented testimony and exhibits showing the cost of equity he derived from his analysis performed for the Montana Consumer Counsel. Copeland noted that the cost of equity has averaged between 13-14 percent for the past few years, and feels that a return on equity in that range would be fair and reasonable. (Exh. MCC A p. 7)

30. In making his return recommendation Mr. Copeland estimated the cost of equity for the past five years. (Exh. MCC A p. 23)

31. As part of his study Copeland performed a descriptive analysis:

Descriptive analysis is the process of making broad generalizations about the financial and market conditions of a firm on the basis of a review of the firm's financial and market performance. In such an analysis, one reviews factors such as the firm's profitability (return on equity), financial policy (retention and payout ratios), and market performance (dividend yield and market-to-book ratio) in order to form an expectation about the firm's future. (Exh. MCC A p. 24)

During the month of June, 1981 the market-to-book ratio for MPC was in the range of 1.09 to 1.26. According to Copeland, the reason for the favorable market-to-book ratio was speculation over the possible sale of MPC's Canadian oil and gas production properties. After performing an analysis of reserve-adjusted book values for the petroleum-producing industry, Copeland estimated an expected return on equity of 14.85 percent. Calculations based upon the current dividend and recent price produced the dividend yield which ranged from 6.73 percent to 7.73 percent. According to Copeland, a dividend yield of this magnitude indicates an expected rate of growth in the dividend that is above the industry norm. It also indicates an expected earnings retention rate that will exceed the historical earnings retention rate. The payout ratio for the past three years has averaged just over 70 percent. Copeland estimates that the future retention rate will average 30 to 40 percent. After examining expected return on equity of 14 to 15 percent, and a retention rate of 30 to 40 percent, Copeland projects a long-term growth rate of about 5 percent. Recently MPC's dividend yield has risen above 8 percent. The combination of a dividend yield of 8-9 percent and an expected growth rate of 5 percent results in an investor-required return of 13 to 14 percent. (Exh. MCC A p. 29)

32. In addition to a descriptive analysis, Copeland performed a technical analysis. The stated goal of the technical analysis is:

To subject the judgment of the analyst to the test of the marketplace, to see whether the judgment of the analyst is corroborated by rigorous statistical analysis. (Exh. MCC A p. 30)

33. Copeland referred to the traditional discounted cash flow (DCF) formula $k = \frac{D}{P} + G$ where k is the investor-required return or cost of equity, D is the current dividend paid to shareholders, P is the price investors pay per share of stock, and G is the expected rate of growth in the dividend. While noting that this theory is widely used, Copeland rejects it as there is no objective way to test it.

34. Copeland described the derivation of the testable hypotheses used in his analysis:

A commonly used version of the DCF equation takes the following form: $k = (1-b)r + \frac{b}{P}$ where b is the earnings retention rate, r is the expected return on book equity, and B is book value per share. Solving this equation for P/B , the market-to-book ratio we get: $P/B = \frac{(1-b)r}{k-b}$ The DCF equation, however, can be rewritten in the following form: $r = k + \frac{D}{B-D/P}$. The testable implication of this equation is that the slope of a regression of r on the quantity $[D/B - D/P]$ should not be significantly different than one (1.0) for firms of comparable risk. (Exh. MCC A pp. 35, 36)

35. The group of comparable companies selected for analysis included MPC and 14 other electric and combination utilities. The sample size of 10-15 companies produces optimum results, according to Copeland.

36. An empirical analysis that consisted of a number of statistical regressions covering the past five years, 1976 to 1980 was performed. In the study, the dependent variable, except for MPC, is a five-year average of each firm's return on equity. For MPC the 1980 five-year average was replaced by 14.85 percent, Mr. Copeland's estimate of the market-expected return on equity.

37. The independent variable $[D/B - D/P]$, was calculated from annual year-end market-to-book ratios and dividend yields. Separate regressions were performed for each year for the period 1976 to 1980. (Exh. MCC A p. 39)

38. In each year except 1980 the relationship between the predicted values and the actual values was "statistically significant." Copeland's model is based upon the concept that the investors' expected growth rate is the growth rate achieved from the internal retention of earnings. The reason for the variance in 1980 was a smaller expected growth rate due to selling stock below book value.

39. To test the reasonableness of his results Copeland repeated his analysis using a sample of ten gas utilities. Although the cost of equity for these gas utilities was slightly above the cost of equity for electric utilities, Copeland indicates that a return on equity of 13-14 percent is fair and reasonable. Since equity costs have until recently ranged toward the upper end of the 13-14 percent range, Copeland recommends a return on equity of 13.75 percent.

Commission Analysis

40. In attempting to determine the cost of equity, the Commission normally evaluates the DCF analysis of witnesses for a utility and the Montana Consumer Counsel. MPC elected not to sponsor a DCF analysis in this proceeding.

41. Use of the discounted cash flow methodology has wide acceptance in the regulatory field. Even when this method is presented by various witnesses there is often a wide divergence in results. However, use of a DCF model does present various measurements which can be reviewed objectively.

42. The testimony of Woy indicates that certain specified financial results will occur should the Commission allow a return on equity of 15.5 percent. While the results of granting such a return might conform to Woy's estimates, the Commission rejects the proposal because no evidence has been offered by the Applicant to indicate that the cost of capital is 15.5 percent. Proper determination of the cost of equity must rely on development of empirical evidence for Commission analysis.

43. The DCF analysis by Copeland was an attempt to derive the cost of equity through the use of a testable hypothesis. Copeland's choice of five year periods for his regression analysis is consistent with past decisions of this Commission. Use of average data insures that normal

conditions are reflected, rather than unusual events not likely to be repeated, which are of little use in establishing the cost of equity for rates to be in effect in the future .

44. Two issues in the testimony of Copeland introduce caution on the part of the Commission. The first issue relates to comparable companies and is addressed by Copeland in his prefiled testimony. Cross-examination revealed that Copeland had presented exactly the same small sample of comparable companies in several proceedings in other jurisdictions (Tr. p. 307). It seems highly unlikely that the group of comparable companies would remain unchanged in cases for different utilities. This Commission has consistently been critical of small groups of comparable companies, as small samples tend to offer results which may not be reflective of the whole capital market. The second area of uncertainty with respect to the MCC DCF analysis is illustrated on (MCC Exh. A, BLC-2 Sch. X). On that exhibit the five year DCF estimate for 1980 for natural gas companies is 14.24 percent. The Commission finds that the most recent five year DCF estimate is more appropriate than the 13.75 percent selected by Copeland.

45. Using the 14.24 percent from Schedule Ten as a base, the Commission finds that an explicit increase of 33 basis points is warranted based upon the following factors:

- (1) Copeland used a small sample of comparable companies. There is no evidence that numerous other companies are not just as valid or more valid for inclusion as comparable companies.
- (2) Over the period of the last several years there has been a substantial loss of market in the natural gas utility. In spite of the decline in the market MPC has been active in promoting conservation through its program of energy audits and zero interest loans. This Commission is strongly committed to the concept of conservation. MPC is to be commended for its promotion for energy conservation.

46. Using the information above, the Commission finds the cost of equity for MPC in this proceeding to be 14.57 percent.

Rate of Return

47. Based on the findings for long-term debt, preferred stock and common equity, the following capital structure and costs are determined to be appropriate:

<u>Type</u>	<u>Capital Structure</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-Term Debt	48.33%	8.81%	4.26%
Preferred Stock	13.58	8.63	1.17
Common Stock	<u>38.09</u>	14.57	<u>5.55</u>
	<u>100.0%</u>		<u>10.98%</u>

PART C

RATE BASE

48. The following rate base proposals were submitted. The final column is the rate base approved by the Commission.

9/30/81 TEST YEAR
(000)

	<u>Applicant Rate Base</u>	<u>Adj. by Consumer Counsel</u>	<u>Adj. by Commission</u>	<u>Commission Approved Rate Base</u>
Utility Plant in Service				
Gas	\$ 161,727		\$ 31,024	\$ 192,751
Common	<u>7,821</u>		<u> </u>	<u>7,821</u>
Total Utility Plant in Service	\$ 169,548		\$ 31,024	\$ 200,572
Accumulated Depreciation & Depletion				
Gas	\$ 55,914		\$ 16,298	\$ 72,212
Common	<u>1,469</u>		<u> </u>	<u>1,469</u>
Total Accumulated Depreciation & Depletion	\$ 57,383		\$ 16,298	\$ 73,681
TOTAL NET PLANT	\$ 112,165		\$ 14,726	\$ 126,891
Gas Stored Underground	\$ 52,811		\$ 8,472	\$ 61,283
Plant Held for Future Use	\$ 1,304		\$ 2,352	\$ 3,656
LESS: Customer Contributed Capital				
Accumulated Deferred Income				
Taxes-Accelerated Depreciation & Accumulated Deferred Investment	\$ 4,876			\$ 4,876
Tax Credits (Pre-1971)	383			383
Customer Advances for Const.	923			923
Accumulated Deferred Income				
Taxes-Amortization of Certain Purchased Natural Gas				
Properties	<u>2,758</u>			<u>2,758</u>
TOTAL CUSTOMER CONTRIBUTED CAPITAL	\$ 8,940			\$ 8,940
PLUS: Working Capital				
Gross Cash Requirements	\$ 3,775		763	\$ 4,538
Credit for Accrued Taxes	(1,282)			(1,282)
Prepayments	4,513		2	4,515
Anaconda Co. Billing Deficiency	(3,190)			(3,190)
Materials & Supplies	2,162		372	2,534
Severance Taxes Accrued	<u>(5,402)</u>			<u>(5,402)</u>
TOTAL WORKING CAPITAL	\$ 576			\$ 1,713
Amortization of Excess Taxes		\$100		\$ 100

Total Gas Utility Rate Base

\$ 157,915\$ 184,702

49. The adjustments to the natural gas rate base in the revised filing proposed by the Applicant are not contested in this case. Both MCC and the Commission accept the Applicant's adjustments to the gas rate base. MCC proposed an adjustment which has the effect of increasing the Applicant's rate base by \$100,000. This adjustment reflects the average reduction in accumulated deferred Federal income taxes that would result in the second year if the excess deferred taxes were amortized over a period of two years. Consistent with the Commission's findings in Order No. 4714a, the adjustment to rate base proposed by MCC is accepted.

50. Based upon its conclusion that Aden is no longer viable to serve the Montana market, the Applicant filed its case with the Aden properties deleted from rate base. For a number of reasons which are elaborated later in this order, the Commission finds that Aden should be included in the gas rate base. This adjustment made by the Commission, increases the gas rate base by \$16,215,000.

51. During the hearing held on January 29th, Mr. Madison indicated that additional annual storage equal to 1.68 BCF could be achieved with the addition of two compressors near Dry Creek. The cost of the new compressors is a million dollars each. Additional storage is viewed by the Commission as providing benefits to both the Applicant and consumers. Injection of A & S gas into storage helps to mitigate take or pay obligations and also provides gas for customers in the future at a fixed price. Inclusion of two new compressors increases rate base by \$2,000,000. These compressors will be placed in service during the period in which rates in this case are in effect. Adding 1.68 BCF of gas increases rate base by \$8,472,000 (this assumes a price per MCF of \$5.043).

52. The total amount of the adjustments in Finding of Fact Nos. 49 to 51 is an increase of \$26,787,000. This amount added to the rate base filed by the Applicant of \$157,915,000 results in a rate base approved by the Commission of \$184,702,000.

PART D
COST OF SERVICE

53. Prior to the discussion of specific adjustments to the cost of service, it will be helpful to review the central issues in this case. Findings of Fact Nos. 11 through 13 delineate the revision to the original filing. The hearing on January 29, 1982 was held to examine the effects of revising all elements of the gas general rate case.

54. MCC "in the supplemental testimony of George Hess calculated revenues based upon the revised data filed by MPC. However, in using that data MCC indicated concern:

. . . if the Commission uses the results contained in the revised exhibits for setting rates in this case, it should clearly state that the adjustments are accepted only in the extraordinary circumstances of this case and do not serve as a precedent for future cases. (Supp. p. 4)

55. Two different revenue requirements were presented by the Applicant in the revised case. The \$3.27 gas supply mix cost is based upon a market which includes sales to the Bird Plant. MPC also presented a gas supply mix cost of \$3.57 which did not allow for sales to the Bird Plant.

56. The stated reason for presenting the \$3.57 cost is that hydro conditions for the spring of 1982 will probably be very good, and, therefore, there will not be sales to the Bird Plant. Since sales to the Bird Plant are an estimate of future conditions, it is difficult to determine if they will occur. Because the \$3.57 gas supply mix cost is based upon an adjustment which is not known and measurable, it is rejected by the Commission.

57. During the hearing in this Docket Woy was asked about the poor financial condition of the company:

Q Mr. Woy, you stated in your testimony that you could not quantify the results attributable to the Commission's actions. Are you able to quantify the reasons for the company's poor financial performance?

A No. I can only respond by saying that our financial performance is the result of several factors. One obviously has to be the poor state of the economy, the raging inflation, just the pure cost of doing business, and included in the whole cost of doing business are all the elements of administrative and general cost and salaries and the burdens on employees and the burdens of regulatory involvement.

It is not inexpensive to conduct rate hearings; it is not inexpensive to comply with the burdens of raising capital to finance plant well in advance of the time that plant will ever go on line and

start to serve and start to become an income-producing factor for the company.

Secondly, the company's performance obviously is significantly affected by the decline in market. I think that this Commission's policies have been to spread our recovery of cost at the levels that are approved by this Commission over a market that is determined in a hearing such as this, and if we are entitled to recover X-million dollars and the market is to be so many million cubic feet of gas, that proportionately, through the rate setting process, we have to sell all of that gas to get all of those dollars back and every Mcf of gas less than that that we sell represents foregone dollars, dollars that we will never get back, and I think it has been well-illustrated in this proceeding that the markets have run away from the Montana Power Company and they have run away from the levels that were used when the rates were set, and it doesn't represent to me a situation where there was a basic failure on the part of the Commission or anybody else. It represents a real life situation that conservation and price elasticity have contributed to a significant decline in the market and we have not been able to get rates in effect that recognize that the costs that we are allowed must be spread over a smaller volume of gas if we are going to be made whole. It's kind of an element of the attrition question that plagues utility companies throughout this country. It's all the same in different sizes and different impacts on different companies, but that's where I believe lies the biggest problem that our company has faced. (Tr. pp. 352-354)

Woy in his answer indicated the factors which have resulted in gas operating losses for the past three years. One of the primary culprits in the poor earnings is the high levels of inflation which has had an adverse effect on the entire economy. Should the current easing of inflation continue, earnings erosion will slow and the frequency of rate filings should decline.

58. A serious factor not cited by Woy is the extreme burden Canadian take or pay contracts place upon the Montana Power Company. These contracts in conjunction with the market decline have resulted in consumer conservation and ever rising gas costs. The Commission notes with interest that a utility in California has been directed by the Public Utilities Commission to seek relief from Canadian take or pay contracts. TransCanada has offered Alberta producers \$1 billion of extra cash payments this year to buy shut-in gas from them. In exchange, TransCanada wants the minimum purchase obligations to be removed from its existing take-or-pay contracts from

November, 1982 onwards. In other words, the producers will no longer have guaranteed minimum sales to TransCanada but will have to take their chances in the marketplace. The Commission urges the Company to seek relief from take or pay contracts as it has in the past.

59. The largest factor in the poor earnings of the gas utility in the view of this Commission, is loss of market. Recent ratemaking changes by this Commission including deferred accounting, gas tracking, and interim relief, have reduced the risk in the gas utility, but loss of market has caused nongas costs to go unrecovered. Both MPC and MCC have calculated revenues based upon the \$3.27 gas supply mix cost. The Commission accepts the \$3.27 revised data for use in determining the revenues in this case. Recognition of the change in market and all associated revenues and costs will provide a market which should allow for recovery of nongas costs. An estimate performed in response to a data request by the Company indicated that if 10 percent conservation were to occur the price per Mcf would increase by .204. The following chart illustrates that there is an economic benefit associated with conservation.

	Average Annual Residential Usage	Residential Usage Assuming 10% Conservation
Price	130 Mcf 4.30	117 Mcf 4.50
Total Yearly Cost	\$ 559.00	\$ 526.50

In accepting the revised data, the Commission notes that this step was taken to meet extraordinary conditions and should not be interpreted by anyone as constituting a precedent for future cases.

Removal of Aden Properties From Rate Base

60. MPC proposes in this case to remove all Aden properties from rate base. The basis for the proposal was stated in prefiled testimony of Donald Percival, which was later adopted by Ralph P. Madison:

The management of the Montana Power Company has reviewed all factors relevant to the future market/supply balance in Montana, and has concluded that the Aden supply source is no longer viable to

serve our Montana customers. (Exh. 4, Direct of D. K. Percival, pp. 2 and 3).

This source of supply has served MPC's Montana gas customers for approximately 30 years (Tr. 133). Thus, MPC's proposal represents a very significant change, one that deserves the Commission's close scrutiny because of its serious ramifications as to future supply and prices for Montana gas customers.

61. Under cross-examination, Madison offered some elaboration of the Company's request that Aden properties be removed from rate base. According to this testimony the proposal seems primarily based on cost of gas from Aden and dependability of supply from that source.

62. At the hearing, Madison testified that if 10 BCF were taken from Aden, its cost would be approximately the same as MPC's most expensive gas, that is, gas purchased from Alberta and Southern, commonly referred to as Carway gas (Tr. 111). Madison further stated that at a 7.5 BCF level, Aden gas "is more expensive and, of course at the two billion level or four billion level, it is more expensive." (Tr. 111).

63. On further cross-examination, Madison admitted that testimony given by Percival in an earlier hearing on August 18, 1981, in this docket, indicated that the "crossover point" for Aden gas, that is, the volumes at which Aden gas begins to cost less on a per unit basis than Carway gas was somewhere between 5 and 6 BCF's (Tr. 130). The discrepancy between the 10 BCF crossover and the 5 to 6 BCF crossover was explained as being due primarily to the Federal Provincial Pricing Agreement, especially the Petroleum Gas Revenue Tax (PGRT) associated with that Agreement (Tr. 130). Another reason for the discrepancy, according to Madison, was that the 10 BCF figure was derived from an analysis much more sophisticated and complete than that which led to the 5 to 6 BCF figure (Tr. 131).

64. The Commission finds several serious difficulties with this testimony. First, the effective tax rate for the PGRT, according to Madison, is "at least four percent," an increase that seems unlikely to cause such a drastic change in the crossover point. Madison was unable to specifically explain how it could have such an effect (Tr. 133). In addition, this claimed affect is in direct conflict with a statement provided in a data request and read into the record, that these tax

changes would not materially change revenue requirements for Aden gas costs (Tr. 272). Finally, although claiming that the analysis that served as the basis for the 10 BCF crossover point was more accurate and refined than that which served as the basis for the 5 to 6 BCF crossover point (Tr. 131), Madison admitted that it, like the earlier analysis was just an "eyeball approach," a "ball park number" (Tr. 213).

65. In reviewing this confusing, contradictory and incomplete evidence regarding whether Aden gas costs are lower, approximately the same or higher than Carway gas, and if so, at what level of take, the Commission finds that it has no substantial evidentiary basis to conclude that the Aden properties are no longer a "viable" supply source for Montana customers on the basis of associated gas costs as is claimed by MPC. Although more information on the subject was requested (Tr. 213) and later supplied, it was not subjected to scrutiny and cross-examination by participants in this proceeding. Therefore, the Commission finds it is inappropriate to rely on this information in concluding that Aden gas is no longer a cost effective source of supply, as is claimed by MPC.

66. An issue not even addressed in MPC's analysis of whether Aden gas will be economical in the future, is the effect on gas prices of current and proposed deregulation schemes for its gas from U.S. sources. In ignoring this factor, MPC also ignores the Commission's specifically expressed concern on the matter in its order for the last general rate increase request:

The Commission is very concerned that Aden reserves be available in future years due to the prospect of U.S. deregulation in 1985...(Docket No. 80.4.2, Order No. 4714a, Finding of Fact No. 122).

Such an obvious issue must be comprehensively addressed before any conclusions can be drawn as to whether Aden remains an economically viable source of supply.

67. Similar problems arise in analyzing evidence offered as support for MPC's claims that Aden is no longer as secure a source of supply for the future as is Carway gas. MPC admitted that it would be dependent on Canadian gas sources "out into the future" (Tr. 142). A major reason given for its desire to rely on Carway rather than Aden is the declining deliverability of Aden (Tr. 143). Despite this claim, however, the record clearly establishes that Tenneco in its negotiations with MPC for gas purchases, specifically preferred gas taken from Aden (Tr. 138). Unexplained in the record

to the Commission's satisfaction is why Tenneco would have had such a preference if, as claimed by MPC, the dependability of supply is highly questionable. At the August hearings Madison noted "... what Tenneco was looking for was a long-term gas supply ..." "They need long term gas." (Aug. 18, 1981, Tr. 38). "Tenneco has a long-term supply problem just like all of us do. They are not really hurting in the short-term, but they are willing to accommodate short-term gas if it does something for them in the long-term (Aug. Tr. 68)."

68. A further issue of future supply is raised by MPC's proposal to eliminate Aden as a future source of supply for Montana customers. In the hearings held in August, MPC presented a future supply scenario showing a significant "gap" between demand and supply beginning in the late 1980's, even at the updated market levels. No firm proposals were presented at that time, or since as to how this gap will be filled. Until that issue is fully addressed, it seems, at best, premature to exclude Aden as a supply source.

69. The Commission has in the past taken a very real interest in the issue of long-term gas supply for MPC's. Montana customers. For example, Docket No. 6720 was devoted entirely to precisely these issues. In addition, the Commission has taken a very active role in determining the sources of gas to assure both a reasonable price and a long-term gas supply. (Docket No. 80.4.2, Order No. 4714a). In view of this involvement and the experience and knowledge gained from it, the Commission cannot accept the conclusory and contradictory evidence offered by MPC at face value.

70. In its proposal to eliminate Aden from rate base, MPC suggests that the only adjustment necessary is to reduce the rate base by an amount equal to its original cost minus depreciation. An issue that has not yet been fully addressed in Montana is the proper rate treatment for productive assets removed from rate base, especially those that have been developed at ratepayer expenses. As evidenced by Tenneco's willingness to buy gas from Aden, and testimony that those properties still have approximately 113.3 BCF in reserves (Tr. 193), they obviously have a substantial market value. The record also establishes that Montana ratepayers have funded exploration and development of gas properties in rate base, including the Aden properties (Exh. 12; Exh. B, p. 13). Whether, if these properties are removed from rate base, additional adjustments such

as those made in other jurisdictions should be made is a question that has not been answered thus far in this docket. (See, for example, Committee of Consumer Services v. Public Service Commission, 595 P.2d 871 (Utah 1979)).

71. MPC's testimony in support of its request to remove the Aden properties from rate base raises many more questions than it answers. It has, in other words, failed to carry its burden of proof showing that its proposal is reasonable and in the best interests of the ratepayers. However, because the issues raised are very important to ratepayers, the Commission cannot summarily reject them. For that reason, on March 23, 1982, the Commission initiated Phase II of this docket in order to fully explore the issues discovered here.

72. Consumer Counsel witness Hess responded to MPC's proposal with an alternative approach. Although in his prefiled testimony (Exh. B) Hess recommended removal of the Aden properties from rate base, he suggested that they should be put back in rate base if gas was sold, presumably to Tenneco (p. 14). In addition, he suggested that MPC should be allowed to capitalize carrying charges on its investment (p. 14).

73. In rebuttal testimony (Exh. 8), MPC witness Woy contested the Hess proposal on the grounds that, since there were no plans to use the Aden source of supply in the future, the Hess allowance "would be meaningless and could not be reflected in our financial statements" (p. 6).

74. The Commission cannot accept the Hess recommendation because it does not address any of the issues of price and supply already discussed. It does not address, nor does it insure that, if the properties are removed from rate base, Aden gas would be available to Montana ratepayers. Further, it does not address how, if the properties are removed from rate base, ratepayers would receive the kind of "credit" upon sale of the properties that he recommends (p. 14). Since the proper treatment of former rate base property that is sold will be decided in Phase II of this docket, the issue must be preserved.

75. Based on its analysis, the Commission finds that there is insufficient evidence to support exclusion of the Aden properties from rate base, especially in view of their historically important role in providing Montana consumers with a reliable supply of natural gas.

76. In view of the many issues and unanswered questions regarding the role of the Aden properties in providing gas to Montana customers, the Commission finds that they should remain in rate base, at least until completion of Phase II of this docket.

77. Pending resolution of the issues to be addressed in Phase II, the Aden properties will be treated in the same manner as storage gas, that is, they should be included at zero take. This treatment will allow ratepayers to have the security of supply now afforded by the availability of gas from these properties, while at the same time allowing MPC full compensation for its investment. The Commission finds that this treatment will in no way harm MPC, and will, in fact allow it to earn a return on its investment that would be unavailable if its own proposal were adopted. Thus, Montana ratepayers retain access to gas from Aden as it does to gas in storage, MPC earns a return on its investment and the status quo is maintained pending further development of evidence as to whether, after 30 years, those properties are no longer used and useful for the convenience of the public.

Amortization of Excess Balance

78. In Docket No. 80.4.2 this Commission ordered MPC to amortize the excess deferred taxes over a two year period. The Applicant declined this adjustment in filing its case as the matter was on appeal to the District Court. Since the decision in District Court affirmed the Commission ruling on this matter, the Company is directed to comply with the second year of the amortization. This amortization reduced operating expenses in the test period by (\$67,000). The refund should be terminated at the end of two years to avoid passing back more than the excess taxes provided. If the Applicant does not file a general gas rate increase in the next year, the refund shall terminate when rates are adjusted in a gas cost tracking proceeding close to the end of the two year period.

Pro Forma Interest Expense

79. MCC proposed a pro forma interest adjustment which was accepted by the Commission in Docket No. 80.4.2. The calculation is performed by multiplying the sum of rate base plus average construction work in progress by the weighted debt cost. MCC obtained a different

result than the Applicant because MCC used its adjusted rate base figure and the weighted debt cost included in its rate of return calculation. The Commission accepted a different result than either the Applicant or MCC obtained, as the Commission used the accepted rate base figure and the accepted weighted debt cost in the calculation of interest expense and the resulting income tax adjustments. The total interest expense for the gas utility is calculated by the Commission to be \$7,267,000. The resulting adjustment to Federal income taxes is a decrease of \$429,000, and the resulting adjustment to Montana corporate license tax is a decrease of \$68,000.

Exploration and Development

80. In Order No. 4714a the Commission granted MPC \$10,000,000 to fund nonCanadian natural gas exploration and development. Since the funding was for expenses only, successful wells do not contribute expenses. MPC had a large number of successful drilling efforts during the test period which reduced the amount of expenses booked for exploration and development.

81 Another problem in gearing up to the level of E & D funded in Order No. 4714a is finding and retaining experienced personnel. Given the high level of drilling in the last two years, it is clear that geologists and other professionals are in great demand.

82. Actual E & D expenses were slightly over \$4 million for a nine month period in the test year. In spite of the problems encountered in establishing a greatly expanded E & D program, the Commission continues to see significant benefits to the Applicant and its ratepayers from this course of action. Gas which is discovered and produced in the United States reduces the need to import expensive Canadian gas under burdensome take or pay contracts .

83. The Commission has estimated the current annual E & D to be \$5.5 million. Due to the factors noted above, MPC has been unable to gear up to the level of E & D mandated in Order No. 4714a. In light of the difficulties experienced by MPC in expending funds for E & D, it is important to set a more realistic level. Accordingly the Commission finds \$6 million to be the appropriate amount of nonCanadian (except for Aden), utility exploration and development expense. MPC is directed to continue to provide quarterly E & D expense reports to the Commission. One year after rates from this order have been in effect, the actual amount expended by MPC on E & D

will be evaluated. Failure to meet the level of expenses specified in this order will result in a revenue decrease. E & D expenses are to be segregated in an account for analysis by the Commission.

Gas Supply

84. MPC witness Don Percival has proposed the following sources of gas supply to meet its market demand:

	Proposed in Original Prefiled Testimony		Proposed in Supplemental Testimony	
	<u>MMCF</u>	<u>\$000</u>	<u>MMCF</u>	<u>\$000</u>
<u>Canadian Gas</u>				
Alberta & Southern (A & S)				
Montana Market	15,571	\$ 77,962	14,167	\$ 71,446
Special Sales	<u>9,881</u>	<u>24,112</u>	<u>9,881</u>	<u>23,547</u>
Subtotal A&S	25,452	\$102,074	24,048	\$ 94,993
<u>Montana Gas</u>				
Purchase	15,656	\$ 37,829	14,527	\$ 36,342
Royalty	7,513	1,879	6,963	2,046
Company Use	<u>(2,317)</u>		<u>(1,612)</u>	
Net Montana	20,852	\$ 39,708	19,878	\$ 38,388
Total Supply	46,304	\$141,782	43,926	\$133,381
Off-line Sales				
Bird Plant		(11,806)		(11,806)
TransCanada		(12,306)		(12,306)
Canadian Utilities		<u>(419)</u>		<u>(419)</u>
Subtotal Special Sales		(24,531)		(24,531)
Storage		<u>(7,739)</u>		<u>(7,505)</u>
Net Gas Cost to Mt. Market		<u>\$109,512</u>		<u>\$101,345</u>

85. MPC filed supplemental testimony on January 6, 1982 to reflect the loss of 2.299 billion cubic feet (BCF) in the Montana market.

86. The Commission finds the loss of the Montana market to be a known and measurable change and accepts it.

A & S Volumes

87. MPC witness Percival in his direct testimony explained why A&S gas was included in the mix at a level above contract minimums:

The total volume proposed to be purchased from Alberta & Southern, including that delivered under special sales, is 25.5 Bcf. This volume consists of 22.31 Bcf, the minimum take-or-pay requirement under the amended Alberta & Southern Gas Purchase Contract, plus 3.4 Bcf to provide for recoupment of gas for which we have made take-or-pay payments to Alberta & Southern in the past. We expect to recoup about one-half of the outstanding deficiency in the contract year ending June 30, 1981 and plan to recover the other one-half during the second year of the two-year period during which the take-or-pay obligation in the Alberta & Southern contract is at a reduced level. (Direct p. 7)

In the revised filing the amount of A&S gas in the mix was reduced to 24.048 Bcf. The new level is based upon the minimum A&S contract volume for calendar year 1982.

88. The Commission accepts the level of A&S gas filed by the Applicant in the revised case. As was noted in Order No. 4714a, the Commission does not approve of the incurring of additional take or pay deficiencies with respect to Carway volumes. As was noted in the Rate Base section of this order, 1.68 Bcf of A&S gas will be utilized to create additional storage.

Aden Gas

89. As MPC requested that Aden not be included in this case, the Applicant did not include any gas from this source in the proposed mix. The Commission finds that while this source of gas is important as a secure source of supply, gas from Aden is not required in the current mix.

Montana Purchased Gas

90. The Company proposed to utilize 14.527 Bcf of Montana purchased gas in the revised case. This is greater than the contract minimum of 13.801 Bcf. Given that the price of this gas is increasing in price due to deregulation, higher takes at this time are prudent. An argument for this level of Montana purchased gas is to provide some flexibility should there be further market loss. For these reasons the Commission finds the level of 14.527 Bcf to be correct.

Montana Royalty Gas

91. Company owned gas is by far the cheapest source of gas available to MPC ratepayers. Rational economic dispatch would dictate that this gas be used first to satisfy market demands. The amount of royalty gas included in the mix by MPC was 6.963 Bcf. Due to the loss of market experienced by the Applicant, the level of royalty gas ordered by this Commission was not achieved. In this case the Commission finds the addition of 1.816 Bcf to the amount filed by the company to be correct. The level of royalty gas approved by the Commission is 8.779 Bcf.

92. The Commission suggests that if further market declines occur, that Montana purchased gas sources be reduced first to contract minimums.

93. The Commission finds the following gas volumes and associated costs:

	<u>MMcf</u>	<u>Cost</u> <u>\$000</u>
<u>Canadian Gas</u>		
A&S:		
Montana Market	14,167	\$ 71,446
Bird Plant	2,229	11,241
TransCanada	<u>7,652</u>	<u>12,306</u>
Subtotal A&S	24,048	\$ 96,993
<u>Montana Gas</u>		
Purchase	14,527	\$ 36,342
Royalty	8,779	2,581
Company Use	<u>(1,748)</u>	<u> </u>
Net Montana	21,558	\$ 38,923

Total Supply	43,926	\$ 133,916
Off-line Sales		
Bird Plant		\$ (11,806)
TransCanada		(12,306)
Canadian Utilities		<u>(419)</u>
Subtotal Special Sales		\$ (24,531)
Storage		<u>(15,910)</u>
Net Gas Cost to Montana Market		<u>\$ 93,475</u>

Aden Expenses

94. The inclusion of the Aden properties at zero take includes the expenses associated with maintaining those properties. The Commission finds an increase in operating expenses associated with the Aden properties in the amount of \$2,661,000 to be correct.

Changes to the Gas Mix

95. The addition of 1.816 Bcf of royalty gas to the mix increases royalty gas expense by \$535,000, decreases other gas supply expense by \$8,405,000, increases depletion expense by \$559,000, increases deferred tax amortization by \$155,000, and increased production tax expense by \$561,000. These adjustments are accepted by the Commission.

Federal and State Income Taxes

96. Changes in the gas mix and the pro forma interest calculation result in a net increase in Federal income tax of \$3,833,000 and a net increase in State tax of \$603,000. These adjustments are approved by the Commission.

COMMISSION ANALYSIS

Market Decline and Risk

97. The bitter irony of rapidly increasing "fixed costs" spread over reduced sales volumes is sharply focussed in this case. Public frustration and outrage is evident in statements such as: "Why

conserve when they just raise the rates to compensate?" To the extent that regulation is designed to emulate the competitive sector, a serious issue must be faced: who must bear the risks associated with a market decline?

98. A strong case can be made that it is the investor who must bear the risk associated with market loss as in the private sector (automobiles, copper, wood products, etc.). The Montana Commission generally shares that view. To find otherwise is to insulate or otherwise guarantee the monopoly investor against this basic business risk. On the other hand, there are utility service obligations and a monopoly profit cap established by rate regulation that are not faced by the private sector. Nonetheless, the performance of the MPC electric utility, where increasing system sales have been the rule, has been very good with earnings at or above the allowed return. This suggests that in a market increase mode there is some "upside potential" for the investor with the same regulatory approach. The reverse case has occurred in the natural gas utility. Therefore, recognizing that there are some fundamental differences between the regulated and private sector, the Commission intends to reflect competitive market conditions to the maximum extent practicable in setting rates.

99. Two factors lead the Commission to approve this extraordinary market update and allow revenues to cover the full level of "fixed costs":

- (1) It is readily apparent that the MPC investor has borne the substantial costs and risks associated with the precipitous decline in the market and the sharply increased operating costs of recent years. The poor or negative earnings of the natural gas utility during that volatile period illustrates that fact.
- (2) The Montana Commission and the State of Montana (15-32-107, MCA) have actively encouraged MPC to promote energy conservation as a matter of prudent energy policy. There exists an obvious conflict of interest (at least in the short-term) between the conservation goal and the investor profit goal unless the full level of the remaining fixed costs are flowed through to the remaining ratepayers. This factor should not be overemphasized, however. In reality the taxpayers of Montana are directly under-writing the MPC residential weatherization program (though the existing interest rate may not cover the cost of capital. Similarly, Montana law and

Commission approved rates have included the advertising and administrative expenses associated with MPC's general conservation efforts. Finally, the Commission has provided a very generous "add-on" to the equity return as a conservation incentive and recognition.

100. The Commission in accepting the extraordinary market update and flow-through of remaining fixed costs to consumers establishes a new base case and regulatory policy. The Commission does not intend to automatically flow through the "fixed costs" associated with market declines to the remaining ratepayers in future cases.

101. The precipitous market decline which has resulted from Canadian price shocks, NGPA pricing, fuel switching, industrial plant curtailments and industrial plant closures is unlikely to be repeated. The utility will have a heavy burden to establish that the surviving "fixed costs" are indeed legitimate and fixed. Likewise, the utility must demonstrate that it is equitable and lawful to require the remaining ratepayers to absorb the market risk rather than the investors.

102. The Commission views the direct conservation obtained through the MPC weatherization program to be a joint or cooperative effort with the State of Montana (15-32-107, MCA). As such the Commission finds that the direct conservation risks and costs will be reflected in rates. Placed in proper perspective, the estimated direct conservation savings resulting from the loan program are at present 0.2 Bcf per year [.33 (150 Mcf/year) (4050 loans)].

103. All other costs and risks associated with market declines reflecting general conservation and fuel switching will be carefully scrutinized. The unnatural "fixed costs" associated with take or pay contracts is of particular concern in that regard. Similarly, the contract terms associated with large industrial loads as they relate to the total "fixed costs" of the utility (including take or pay obligations) and the resulting risks to the ratepayers and investors must be carefully examined. It is apparent that the precipitous industrial load loss is a key factor in the current situation.

104. Finally, the Commission expects the Company to provide a comprehensive demonstration that all costs have been cut to the maximum extent practicable consistent with its public utility obligations. Such examination should again include all options relating to take or pay

contracts (termination, renegotiation, settlement, etc.). For example, the actions of TransCanada, Pacific Gas and Electric, and the California Public Utilities Commission should be carefully evaluated. Similarly, the Oregon Public Utilities Commissioner has predicated extraordinary treatment of Pacific Power and Light, et al., upon a commitment to substantial overall cost reductions. The ongoing request of the Montana Commission and in particular Chairman Bollinger for a substantial showing on utility efficiency is a key element for the Commission to establish just and reasonable rates reflecting only legitimate costs.

Revenues & Expenses

The following income and expense proposals were submitted. The final column contains the revenue and expense amounts approved by the Commission:

9/30/81 TEST YEAR
(000)

	<u>Applicant=s Revenues & Expenses</u>	<u>Consumer Counsel Adjustments</u>	<u>Commission Adjustment</u>	<u>Approved Revenues & Expenses</u>
Operating Revenues	\$143,248	\$	\$	\$143,248
Cost of Service:				
Production Operation (Excl. Royalties)	1,895		583	2,478
Production Operation-Royalties	2,046		535	2,581
Production-Operation Maintenance	736		291	1,027
Products Extraction-Operations	21			21
Production Extraction-Maintenance	2			2
Exploration and Development	8,263		(2,263)	6,000
Other Gas Supply	100,474		(8,405)	92,069
F. W. Bird Plant - Cost	11,241			11,241
TransCanada	<u>12,306</u>			<u>12,306</u>
Sub Total Other Gas Supply	\$124,021			\$115,616
Revenue Reclassified				
Re: F.W. Bird Plant	(11,806)			(11,806)
Re: TransCanada Sale	(12,306)			(12,306)
Re: Canadian Utilities	<u>(419)</u>			<u>(419)</u>
Total Other Gas Supply	99,490			91,085

(Continued)

	<u>Applicant=s Revenues & Expenses</u>	<u>Consumer Counsel Adjustments</u>	<u>Commission Adjustments</u>	<u>Approved Revenues & Expenses</u>
Storage-Operations	209			209
Storage-Maintenance	71			71
Transmission-Operations	725			725
Transmission-Maintenance	631			631
Distribution-Operation	2,314		2	2,316
Distribution-Maintenance	906		1	907
Customer Accounts Expense	1,701		4	1,705
Customer Service and Info. Expense	575			575
Sales Expenses	92			92
Admin. And General Expenses	6,454		474	6,928
Labor Adjustment	1,291			1,291
Clearing Account Adjustment	38			38
Trans./Power Op. Equip. Adj.	32			32
Cost of Service Adjustment	(131)		131	
Sub Total	\$127,361			\$118,714
Depreciation Expense	5,778		559	6,337
Amortization of Common Utility Plant	34			34
Amortization of Invest. Tax Cr-Cr	(73)			(73)
Prov. For Def. Inc. Tax-Accel. Depr.	1,183			1,183
Prov. For Def. Inc. Tax Amort. Of Certain Purchased Nat. Gas Prop.	594		155	749
Prov. For Def. Tax-Corp. Lic. Tax	(115)			(115)
Amort. Excess Federal Tax Balance		(67)		(67)
Taxes Other than income Taxes	5,264		851	6,115
Income Taxes-Federal	(3,791)	(242)	3,912	121
Income Taxes-Corp. License Tax	(612)	(38)	616	4
Sub Total	8,262			14,288
Total Expenses	135,623	(347)	(2,554)	133,002

(Continued)

	Applicant=s Revenues & <u>Expenses</u>	Consumer Counsel <u>Adjustments</u>	Commission <u>Adjustments</u>	Approved Revenues & <u>Expenses</u>
Utility Operating Income	7,625			10,246
Amort. Of Profit on Debt Reacquired At Discount	<u>5</u>			<u>5</u>
BALANCE FOR RETURN	7,630			10,251
Natural Gas Utility Rate Base	157,915		26,787	184,702
Rate of Return Earned	4.83%			5.55%

PART E

REVENUE REQUIREMENT

105. The Commission finds that the additional annual revenue (in addition to Order No. 4775 revenues) required in the Applicant's gas operations is \$20,741,000 as follows:

	(000)	
Rate Base	\$184,702	
Recommended Rate of Return	10.98%	
Recommended Return		\$20,280
Balance for Return		<u>10,251</u>
Return Deficiency		\$10,029
 <u>% of Revenue</u>		
Revenue Deficiency	100.00	\$19,930
 Operating Revenue Deductions		
MCC Tax @ .07%	<u>.07</u>	<u>14</u>
State Taxable Income	99.930	19,916
State Tax @ 6.75%	<u>6.745</u>	<u>1,344</u>
Federal Taxable Income	93.185	18,572
Federal Income Tax @ 46%	<u>42.865</u>	<u>8,543</u>
Net Operating Income	<u>50.32</u>	<u>\$ 10,029</u>

The revenues granted in these Dockets result in a total revenue increase of \$21,551,000 over rates found in Docket No. 80.4.2.

PART F

RATE DESIGN

106. The Commission has received numerous complaints regarding the lifeline period, which was intended to cover usage between December 1st and March 30th. Because of cycle billing, the practical application has been that these rates for each customer apply to four billing periods in which the usage can range anywhere from December 1st through April 30th, depending on when meters are read. The Commission finds that the only practical method of alleviating late April from the lifeline period is to move the period forward 15 days so that meter readings between December 15th and April 15th apply. The Commission realizes that this cuts 15 days from the 1982 eighth

month recovery period. The Company should compute the revenue affect of this charge based on normalized consumption amounts in this case and submit it with its next deferred accounting case.

107. No testimony was given by any party challenging the present rate design. Therefore, the Commission finds that the rate design used in Docket No. 80.4.2 is proper and the revenues in this order should be recovered using the same methodology.

PART G

OTHER ISSUES

Economic Recovery Tax Act of 1981

108. On April 23, 1982 MPC filed a letter with the Commission requesting language in this order pertaining to normalization of tax benefits associated with the Economic Recovery Tax Act of 1981. The Commission recognizes that because ERTA is so new, the IRS has not issued regulations with respect to the new normalization requirements. The Commission approves normalization of accelerated tax depreciation benefits for property covered by the Economic Recovery Tax Act of 1981. This action does not affect revenues in this Docket since no "recovery" property has been included in the rate base.

Audit/Weatherization Program

109. The Commission is aware of the efforts of MPC to encourage energy conservation through energy audits and zero interest loans. During the hearing in this Docket MPC indicated that a new program (ESP II) is being prepared. The Commission hopes that this new program will result in significantly improved performance. The following areas of improvement are identified by the Commission, in order of priority:

ANNUAL

1. Loans per audit conducted
2. Low income loans per low income energy assistance qualified customer
3. Audits per total audit/weatherization program dollar
4. Loans per thousand customers
5. Audits per thousand customers
6. Loan size.

110. Toward these ends, the Commission is amenable to program modifications such as: Leaving repayment obligation with rental structures to be paid by subsequent residents; no liens upon owner occupied dwellings; pay back periods to seven years for low income energy assistance qualified customers; a nominal service charge (\$10) for audits to improve customer commitment; auditing contractors; and use of federal and state tax benefits pertaining to renewable energy equipment. The Commission would contemplate that the loan limit for renewable equipment (particularly solar hot water heating equipment) would be "grossed up" by the amount of the tax benefits, which the customer would pay to MPC on April 15th of the following calendar year. For example, if the current loan limit were \$1,500 and a 40 percent tax credit were available for renewable energy equipment, the company could loan $X - .4X = 1500$ or \$2,500. The \$1,000 tax credit would be paid to the company at April 15th of the following calendar year. Monthly payments on the \$1,500 balance would not be affected. In summary, the Commission expects significantly improved emphasis and performance in the audit/weatherization program.

CONCLUSIONS OF LAW

1. Applicant, Montana Power Company, is a corporation providing natural gas services within the state of Montana and as such is a "public utility" within the meaning of Section 69-3-101, MCA.
2. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's operations pursuant to Title 69, Chapter 3, MCA.
3. The rate base adopted herein reflects public utility property "actually used and useful for the convenience of the public" at original cost depreciated values and as such complies with the requirements of Section 69-3-109, MCA, that the value placed upon a utility's used and useful property for ratemaking purposes "...may not exceed the original cost of the property."
4. The rate of return allowed meets the constitutional requirement that a public utility's return must be "commensurate with returns on investments in other enterprises having corresponding risks and sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain

its credit and to attract capital." Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 603 (1944).

5. The Commission acts in its legislative capacity when it allocates utility costs to the various customer classes.

6. The objectives of conservation, efficiency and equity are promoted by the rate structure approved in this order.

7. The rate structures authorized by the Commission, based upon analysis of the entire record, are just, reasonable, and not unjustly discriminatory.

ORDER

1. This order makes permanent the additional revenue granted in Order No. 4775. Also, this order makes permanent the amortization of the accumulated negative deferred gas cost balance (\$1,481,671). Those revenues in addition to existing revenues result in present revenues of \$143,248,000. The revenue requirement calculation in this proceeding indicates that \$19,930,000 in additional annual revenue is required. The revenue granted in this order and the interim revenues which have been collected are final and not subject to rebate. Montana Power Company is directed to file rate schedules which recover \$163,178,000.

2. Rate schedules filed shall comport with all Commission determinations set forth in this order and in such manner so as to set rates in accordance with the volumetric pricing methodology maintaining the 25 percent differential between winter discount and remainder of year sales.

3. All motions and objections not ruled upon are denied.

4. This order allows expenses for the Aden properties at a zero take. Should a sale of gas to Tenneco take place, the Commission directs MPC to offset Aden expenses granted in this order against that sale to the extent possible.

5. Montana Power Company is directed to provide data in the next general gas rate case data to enable the Commission to perform ratio analysis.

6. Should the Montana Power Company receive a reduction in take or pay requirements, the gas mix should be adjusted and rates should be changed immediately.

Done and Dated this 10th day of May, 1982 by a vote of 5 - 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

GORDON E. BOLLINGER, Chairman

JOHN B. DRISCOLL, Commissioner

HOWARD L. ELLIS, Commissioner

CLYDE JARVIS, Commissioner

THOMAS J. SCHNEIDER, Commissioner

ATTEST:

Madeline L. Cottrill
Secretary

(SEAL)

NOTE: You may be entitled to judicial review of the final decision in this matter. If no Motion for Reconsideration is filed, judicial review may be obtained by filing a petition for review within thirty (30) days from the service of this order. If a Motion for Reconsideration is filed, a Commission order is final for purpose of appeal upon the entry of a ruling on that motion, or upon the passage of ten (10) days following the filing of that motion. cf. the Montana Administrative Procedure Act, esp. Sec. 2-4-702, MCA; and Commission Rules of Practice and Procedure, esp. 38.2.4806, ARM.